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SENSITIVE

E.O. 12958: N/A

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SUBJECT: TURKEY: SLOW PROGRESS ON ELECTRICITY  
DISTRIBUTION PRIVATIZATION

Ref: Ankara 2114

Sensitive But Unclassified. Please handle accordingly.

1. (SBU) Summary: Turkey's privatization of its electricity distribution company is proceeding slowly. All parties anticipate some delays, most likely to at least this autumn, primarily due to delays in putting in place important legislation underpinning process and mechanisms, but everybody gives importance to getting it right. American firm AES is still very interested in this market opportunity. End Summary.

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Pending New Legislation  
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2. (SBU) The GOT has delayed announcing tenders for regional electricity distribution privatization because of lingering uncertainties on process and approach, as well as the need to provide related legislative amendments to the existing electricity law. The Privatization Administration (PA) was successful in arguing for a "transfer of operating rights" (TOR)-backed share sale model, over a direct sale approach (reftel). The new draft law, which is intended to codify the "Electricity Strategy Paper" and resolve disputes and open-ended issues, has been forwarded to the Council of Ministers for signature, before transmittal to the Parliament for approval. The amendment is intended to:

- Minimize constitutional and other legal objections to the privatization.
- Enable foreign majority ownership in individual electricity distribution and generation companies (but includes an ambiguous stipulation that precludes foreign domination in the overall sector).
- Enable the Energy Ministry to permit new public sector investments in energy "in order to ensure the security of supply".
- Preserve the 20 % limit on amount of regional generation that can be controlled by distribution companies (PA unsuccessfully sought to raise this pro-competition provision to provide greater enticement to investors).

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Enthusiasm and Critiques  
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3. (SBU) In a June 3 meeting with Energy Officer, Energy Market Regulatory Authority (EMRA) Electricity Market Head Murat Erenel said he was pleased with the current draft. Although he was frustrated with the delay in passage, he stressed the need to make the process clear and get it right. Noting that the Parliament would go on summer recess at the end of June, he said that the tender process would be delayed to autumn, or even to next spring, because of the need for the PA to make preparations based on the new law. Erenel lamented that there were still some transitional issues cited in the Electricity Strategy Paper that will still unachieved: transitional contracts between the state electricity companies; balancing and settlement procedures with the state trading company TEIAS, and the future status and role of the state distribution company TEDAS.

4. (SBU) Ministry of Energy Director General Budak Dilli expressed similar concerns to Energy Officer in a meeting on June 3. He noted that the new law and/or subsequent implementation had to clear up transitional contracts, TEDAS' role, and tariff mechanisms. In a separate meeting, Energy Under Secretary Sami Demirbilek expressed frustration with the PA's aggressive attachment to the TOR model. He told ECON/C that he continued to fear this complex approach would discourage the most qualified and serious foreign companies from bidding; he encouraged

prospective investors to express opinions to the Treasury, Finance, and PA.

15. (SBU) Local World Bank expert Gurhan Ozdora expressed frustration over delays and lack of coordination between relevant agencies (not listening to each other). He was pleased with progress on the law draft, but noted that the market structure was still based on "shifting sand." Ozdora noted that privatization and liberalization of electricity distribution was a key test and a precursor for the next step of generation. Ozdora observed that there was a bureaucratic reluctance to make key decisions and signatures, for fear of a future investigation from the next government.

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Interest from American Firm AES  
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16. (SBU) Visiting AES manager for Turkey, John Turner, met June 2 with Energy Officer and FCS specialist. AES remains seriously interested, having identified Turkey as a key market. The AES CEO is planning to come to Turkey for high level meetings around June 28-30. AES plans to hire a local consultant and establish an office in Ankara. AES is still looking at both Oyak and Enka as potential local partners.

Turner described the following issues still in play:

-Still a perception of weak coordination and political will with respect to clearly setting process and timing for distribution privatization.

-The proposed electricity law amendments are still at the Prime Ministry, so timing is unclear. The Parliament will go on summer recess at the end of June.

-The Privatization Authority has successfully pushed its preferred "Share Sale based on Transfer of Operating Rights" method. AES said it can live with this, but would have preferred an "asset sale" approach (AES understands the argument that there were practical legal difficulties and potential challenges associated with an asset sale method).

-Incentives for investors still in play. PA had championed lifting the 25% cap on production which could be owned by a distribution company (to entice investors). EMRA and others have appeared to successfully push back on this vertical integration issue.

-Tariff mechanisms and a regional equalization fund still unclear. Transitional contracts between entities still unclear. The role and status of TEDAS (the state distribution co.) still to be determined.

-Prequalification criteria still unclear and intensely political. AES will satisfy either way and would prefer a high bar. But a high bar for experience might preclude some domestic actors.

-AES has a tax issue as a U.S. company. The distribution companies have been created as joint stock companies (anonymous companies); AES will want to convert to a limited partnership legal structure to avoid a tax disadvantage.

-The press notes that there are still issues about foreign control and ownership of the distribution companies on an overall basis (but not on an individual distribution company basis).

-PA is working on auditing and information memoranda to start with tenders for six more lucrative, western regions (of the 21 established). It is not clear, but usually assumed, that PA has to wait for passage of the law (to make the process and environment fully clear). AES said PA said Russian companies are interested in eastern regions.

17. (SBU) Comment: Along with Turk Telekom, TUPRAS refining company (septel), and others, electricity distribution is identified as a key target for privatization. The GOT cannot afford more failures on privatization, so delays - to get it right - are reasonable, up to a point. The forces unwaveringly opposed to privatization - especially to foreigners (judiciary, labor unions, nationalists) are gearing up for action, and it is difficult to predict speedy privatizations, other than IPO's which do not transfer control.

Moore